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## PORTLAND BUSINESS JOURNAL

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From the October 3, 2003 print edition

### NBS equity fund targets regional market

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A real estate investment strategy that works on a national level is being scaled back to fit the Pacific Northwest, with a new private equity fund created by [NBS Real Estate Capital](#).

The principals of Norris, Beggs & Simpson and NBS chief executive Rance Gregory make up the principals of the new company, NBS Real Estate Capital, which seeks a \$30 million investment in its first fund, Morrison Street Fund I LP. The company has amassed \$10.8 million so far, including \$1 million contributed by NB&S partners.

While national equity funds supply hundreds of millions of dollars in private funding for large-scale projects, NBS Real Estate Capital intends to create a small-scale fund targeting regional properties and investments.

"We're taking the same investment model that has been successful nationally, sizing it right, and getting closer to the ground on these deals," said Gregory. "From a macro view, Portland is an inefficient market, because institutional capital can't come here and buy anything large enough [to make it worth their while]. We don't have a bunch of U.S. Bancorp Towers for sale. But we can do this on a smaller scale and make it work."

The private equity fund will be used for three kinds of real estate investment. Mezzanine financing is like a second mortgage on a house, in that the debt is subordinate to a property's primary financing. Preferred equity is similar to mezzanine financing, but it is used when a senior lender refuses to allow more debt on the property. Instead, a preferred equity partner receives profits even before the property owners get their share.

NBS Real Estate Capital will also buy properties in the metropolitan areas of Oregon, Washington, Idaho and Nevada to create a balanced portfolio of debt instruments and real estate assets.

But some local lending experts think the equity fund won't see much demand from borrowers.

"There is not a lot of demand for mezzanine financing in Portland, and there never has been," said Lloyd Minten, senior managing director of Holliday Fenoglio Fowler LP. "That's one reason why the Wall Street firms have never come in here."

J. Clayton Hering, president of Norris, Beggs & Simpson, said he hopes the new company will serve NB&S clients' needs. Gregory said some NB&S clients who finance their real estate purchases get less money from their primary lender than they'd like, but NBS Real Estate Capital could step in to fill the gap.

"Senior lenders are dying to put out money, but they see the stress in the market and cut back on their loan-to-value ratio in the senior loan," Gregory explained. A cautious lender might offer a loan on 65 percent of the value of a building, rather than the 75 percent the buyer hoped to finance, and a mezzanine loan or preferred

equity could make up the difference.

But Minten believes the demand for that financing is limited, because "the borrowers here retain more equity in a transaction than in other markets. Therefore, on a mezzanine side I see a very narrow market for that in the Portland metro area, and whether [the lending company is] small or large, it doesn't make any difference."

Gregory previously worked for Donaldson, Lufkin & Jenrette, and following a merger, Credit Suisse First Boston, where he was the Los Angeles-based principal of DLJ Real Estate Capital Partners, and managed more than \$1.3 billion in assets. He moved to Portland in late 2002 with his wife Allison, a Portland native.

Gregory believes the new private equity fund will "fly below the radar screens" of the institutional lenders, but Gary Griff, director of real estate finance and financial services at Cushman & Wakefield, believes there is little demand for this in Portland.

"In some markets, there's room for everybody, but in this market it's going to be a little tough," Griff said. "Demand seems to be there in larger markets, where there are more investment dollars and more competition comes into play. There just haven't been very many investment opportunities here in Portland the last two years."

Griff added that life insurance companies are heavily promoting their mezzanine debt programs, and they're after the same business as NBS Real Estate Capital. However, he believes NBS might have a home court advantage. "If NBS is concentrating locally, they're going to have an advantage just because of local knowledge and local contacts, because they're on the ground more and they're going to be able to move more swiftly," Griff said.

NBS Real Estate Capital will diversify its fund with four types of investment. Product types will include office, retail, industrial and multifamily housing; investment types will include direct equity, preferred equity and mezzanine debt; investments will be geographically diversified throughout the Northwest; and NBS will mix the level of stabilization in its assets to include fully leased properties and value-added opportunities.

"We are entering a phase in this unique real estate cycle where we could see prices for non-stabilized assets flatten or decrease even as market fundamentals begin showing signs of improvement," Gregory said. "With interest rates increasing recently, we are starting to find pricing anomalies and early signs of owner distress that will create investment opportunities for NBS Real Estate Capital, particularly in situations where we can offer the fund's preferred equity and mezzanine debt solutions to capital-constrained investors and developers."

Many investors have poured money into real estate investments as an alternative to the stock market. They have many options: Real estate investment trusts, or REITS, are Securities and Exchange Commission-regulated companies that sell stock in the company.

Private equity funds are typically limited to sophisticated investors; they do not have the same SEC governance and are thus limited in the way they can advertise their funds. They are also typically "blind funds" in which the fund manager picks the investments, not the investor. Investors might also choose syndicates, which allow them to buy a share in a property of their choice, or they might fly solo by owning real estate independently.

Investors in the Morrison Street Fund I include high net worth individuals, banks, pension funds, charitable trusts, foundations and corporate investors. Gregory, on advice from legal counsel, would not disclose the number of investors or the specific criteria for investments.

Although NBS Real Estate Capital is currently housed in Norris, Beggs & Simpson's downtown office, Gregory said he intends to move out on his own and hire a total of four staff within a year. Gregory sees his business as complimentary to what Norris, Beggs & Simpson does, and he plans to avoid conflicts of interest by maintaining some distance from the 71-year-old firm.

"This vehicle was designed to work with the NBS clients, and not compete with them," Gregory said. "The advantage is that Norris, Beggs has relationships with owners and borrowers, and we can use that to team up with people and work with them."

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